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C O N F I D E N T I A L SECTION 01 OF 03 KUWAIT 000111

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TAGS: EFIN EINV ECON KU
SUBJECT: KUWAIT'S CABINET PASSES RESCUE PACKAGE

REF: A. KUWAIT 79
¶B. KUWAIT 23
¶C. KUWAIT 8
¶D. 08 KUWAIT 1155

Classified By: Econcouns Oliver John for reasons 1.4 (b) and (d)

¶1. (C) Summary: Kuwait's cabinet approved draft legislation to support Kuwait's banking sector by guaranteeing or purchasing distressed assets for up to 15 years. The draft legislation also encourages new lending to "the real economy" and has provisions to address liquidity and solvency problems at investment companies (although the bill puts much more stringent terms on investment companies accepting assistance). Most bankers have been generally supportive of the bill. The bill does not provide for consumer debt relief, though that may be added by Kuwait's National Assembly. According to a senior Gulf Bank executive, several key shareholders waited until the last minute to subscribe to the bank's re-capitalization efforts. Had they not, KIA would have effectively nationalized the bank instead of taking only a 16% share. Kuwait devalued the dinar against the dollar to the level it was at in 2007, when the GoK dropped the dollar peg. End summary.

K-TARP (or the GoK bail out package)

¶2. (SBU) On February 5, Kuwait's cabinet approved draft bail out legislation submitted by the Central Bank. The law will be passed to the National Assembly for debate and approval. Kuwaiti bankers are largely positive on the draft and Kuwait's stock market rose when the bill was submitted to the cabinet. The draft law focuses on three key areas: banks, "the real economy," and investment companies.

¶3. (SBU) Under the proposed law, the Central Bank would be empowered to provide banks with guarantees for distressed assets and/or to authorize the Kuwait Investment Authority (KIA) to purchase such assets. Central Bank guarantees for distressed assets (held by banks as of December 31, 2008) would last for up to 15 years. These guarantees would include any deficits in banks, required provisions for nonperforming loans and guarantees for devaluations in financial investment and real estate portfolios. Banks would be required to seek financing from other sources and also to reduce the value of the guarantees annually after 31 December
¶2011. Banks would be required to pay a one percent (of the guarantee) annual fee. The GoK also has the opportunity to purchase distressed and defaulting assets for the next three years in exchange for stocks and bonds issued by the Kuwait Investment Authority (KIA). In the event that a bank is unable to increase its capital, KIA will have the right to purchase convertible bank bonds, premium stock shares, or any other financial tools that conform to Islamic Sharia.

¶4. (SBU) The government will guarantee up to 50% of the amount of new loans to Kuwait's economic sectors (business, industrial, construction, real estate, oil and gas, and certain other sectors) for CY 2009 and CY 2010. The total of

these guarantees should not exceed 4 billion KD ($13.5 billion) and the funds must be used locally. Banks are prohibited from using the new loans to pay off pre-existing loans and the maximum duration of the loan will be no more than five years.

¶5. (SBU) The draft law also deals with Kuwait's troubled investment companies (such as Global Investment House; ref c). It sets up three categories of troubled investment companies: solvent companies (facing liquidity problems) whose collapse would have a systemic impact; solvent companies (facing liquidity problems) whose collapse would not have a systemic impact; and insolvent companies whose collapse would have a systemic impact. The Central Bank would determine in which category an investment company belongs based on the extent of its financial ties into the local economy or its debts toward international financial institutions combined with its "financial entanglement" with other legal parties. The law gives the Central Bank the authority to determine an appropriate response. It could guarantee 50% of new loans to solvent companies to cover its commitments to local (non-bank) parties and up to 25% of their debts to foreign banks and financial institutions (as a result of restructuring these loans). For insolent investment companies (of systemic importance), KIA will cover exiting commitments to non bank creditors through cash payments of up to 100,000 KD for each creditor, and to issue bonds as collateral for the rest of the loan. The Central Bank will then appoint a managing bank to reschedule the investment company's debts to banks and will be able to request a judge to order the company to restructure.

¶6. (C) Dr. Mohammed Al-Hashel, the new Deputy Governor of the Central Bank, told EconCouns and visiting officials from the Federal Reserve Bank of New York that the draft law was designed to ensure the security of the banking sector. He was unwilling to offer an estimate of the size of the package until the government had a better idea of the size of the problem, but admitted that it would be important to have a number to give to the Parliament. He also admitted that obtaining parliamentary approval would be more difficult than obtaining cabinet approval. He explained that the concern for the Kuwaiti banking sector was not investments (which were relatively small), but with potentially non-performing loans. The guarantee program was designed to give banks time to build provisions for non-performing loans and to encourage new lending to the real economy. Dr. Hashel took substantially the same position taken by the Central Bank Governor with regard to Kuwait's investment companies, i.e., that their shareholders should be primarily responsible for recapitalizing them (ref b). He did acknowledge that there could be a systemic risk should these investment companies collapse, so the plan would provide incentives for banks to extend new loans to help the investment companies meet their existing obligations. With regard to banks, however, Dr. Hashel stressed that the GoK could not afford to wait. The Central Bank quickly moved to get a deposit guarantee law passed in the wake of the Gulf Bank crisis to forestall any bank run, and the GoK currently guarantees about 30.5 billion KD in deposits ($102.8 billion) out of Kuwait's General Reserve Fund. Several of our banking sector contacts have given a generally positive assessment of the bill. One banker commented that it was about time for the government to act and that given the financial assets available to Kuwait there was no need for the country to have this crisis.

Gulf Bank Recapitalization

¶7. (C) On January 26, Gulf Bank announced that it had completed its recapitalization, with existing shareholders taking the bulk of the new issues and KIA taking a 16% stake in the bank. A senior bank executive told Ambassador that the recapitalization had been "a touch and go" exercise until

the last minute, with shareholders concerned about increasing their exposure to the bank in the current challenging market conditions. The executive speculated that rumors of Kuwait's rescue package shaping up might have helped. Gulf Bank Chairman, Kutayba Al-Ghanem, only elected to participate at the "11th hour" and had already notified shareholders that he would not participate. Most of the bank's original shareholders elected to participate, although Bassem Al-Ghanem (Kutayba's brother and the chairman of the bank when it collapsed) did not. As a result, Bassem's share in the bank has been cut in half to 10%. The bank executive commented that the family feud between Qutaiba and Bassem over the division of the family's assets is continuing and is "clearly going to litigation." The original terms of the family "divorce" were signed in 2007, when the two agreed on how the assets would be split; however, Gulf Bank's value has since plunged. Qutaiba is also looking for evidence of malfeasance in Bassem's running of the bank. The Attorney General's investigation of possible criminal activity with regard to the bank's losses continues, but the official stressed that there did not appear to be any criminal activity.

Dinar Devaluation

¶8. (SBU) At the end of January, the Central Bank of Kuwait caught bankers by surprise when it devalued the Kuwaiti dinar against the dollar approximately to the level it held in ¶2007. This represented a relatively large one day drop in the value of the dinar, and one that did not appear to track any sharp movement in the value of the dollar against other major currencies. The GoK maintains a peg to an undisclosed basket of currencies, but banks and financial institutions have their own formulas that track the movement of the KD to a greater or lesser extent. The drop led to some speculation that Kuwait was planning to re-peg against the dollar.

¶9. (C) Although Dr. Al-Hashel refused to comment, he did say that Kuwait would be prepared to re-peg when, and if, the countries of the GCC were ready to implement a currency union. He noted however that he was skeptical of the GCC's ability to meet its 2010 timetable. Most bankers and financial analysts we have discussed this subject with do not believe that this move is in preparation for an imminent re-peg. They note that the dollar has strengthened against the Euro and that this recent move in the dinar still represents a real appreciation of four to five percent on the Euro. In addition, they note that inflation worries (a key reason for Kuwait dropping the peg) have declined and that

devaluing the KD against the dollar will give the GoK more KD with which to address their new domestic bail out package.

Comment

¶10. (C) The GoK has finally prepared a draft "bail out" package to pass to the National Assembly. Although the GoK has taken ad-hoc steps to protect the country's financial system, it has come under strong parliamentary criticism for not acting more swiftly and comprehensively to address the costs of the global financial crisis to Kuwait. The plan, as it stands, clearly reflects the views of the Central Bank Governor: protect the banking system and encourage the unfreezing of the domestic credit market. Although KIA reportedly already has a fund that would allow it to invest in blue chip companies on the Kuwaiti Stock Exchange (KSE), this bill does not specifically provide for a KSE bail out plan. Nor does it forgive the consumer debts of individual Kuwaitis, which some Members of Parliament have called for. Some sort of consumer debt relief provision may be added by the National Assembly. Perhaps surprisingly, given the dominant role the government plays in Kuwait's economy, the bill also does not provide for any fiscal stimulus. In fact,

Kuwait's draft FY 2009/2010 budget currently is projecting some cuts in government infrastructure spending (which tracks what we are hearing anecdotally). Post does not believe that the recent drop in the value of the dinar versus the dollar indicates an imminent re-peg. The fact that the dinar is pegged to an undisclosed basket gives Kuwait the ability to have a managed float. With inflation declining as a concern and the GoK's major revenue source (oil) valued in dollars, the devaluation will give the GoK more KD for its domestic stabilization efforts. End Comment.

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JONES